



State-Owned Enterprises in Georgia:
Transparency, Accountability and Prevention of
Corruption

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Introduction

Georgia has made significant progress in terms of combating corruption as a result of reforms implemented since 2004. Some types of corruption (e.g. bribery in public services) were brought to a minimum, while the efficiency of administration and bureaucracy increased.

The challenge currently facing Georgia and its government is to prevent more complex forms of corruption. Such forms of corruption often involve illegal deals made by high-ranking officials that take place in the areas where the government and business interact.

The following report explores corruption risks in state-owned enterprises. This topic has been a subject of growing attention from organizations and researchers working on anticorruption policy.

This study attempts to answer the following questions:

- What are the main risks of corruption in state-owned enterprises?
- What are the most effective mechanisms for preventing corruption in state-owned enterprises based on international experience?
- How well does the current Georgian legislation prevent corruption in state-owned enterprises?
- How effective are the anti-corruption mechanisms employed by the country's largest state-owned enterprises?

In order to answer these questions, the report looks at five large companies that were founded by the Georgian government, four of which are currently being managed by the Partnership Fund and one by the LEPL National Agency of State Property:

- JSC Georgian Railway
- Georgian Post Ltd.
- JSC Georgian Oil and Gas Corporation
- JSC Georgian State Electrosystem
- JSC Electricity System Commercial Operator

The report also discusses issues related to the transparency and accountability of the Partnership Fund.

Based on the analysis of above cases, the report presents recommendations for the government of Georgia, which should help reduce corruption risks in state-owned enterprises and increase the effectiveness of the government's anticorruption policy.

1. Overview

Based on international experience and practice, we can identify a number of questions that are important for the prevention of corruption in state-owned enterprises and of any possible use of these enterprises for private gain:

- Legitimate reason for setting up a state-owned enterprise and its clearly stated objectives.
- Effectiveness of a state-owned enterprise management model.
- Transparency of activities of state-owned enterprises (which includes proactive disclosure of various types of information and extension of freedom of information standards to these enterprises).
- Clear separation of the government's roles as a market regulator and an owner of an enterprise.
- Clear and detailed rules for the appointment and functioning of the governing body of a state-owned enterprise.
- Introduction of internal control mechanisms, ethic norms, rules of conduct and anti-corruption procedures in state-owned enterprises.
- Reducing political influence over state-owned enterprises to a minimum and preventing interference by political parties.

Georgian legislation on state-owned enterprises contains a number of shortcomings:

- The legislation does not establish criteria for the establishment of a state-owned enterprise or legitimate goals of such enterprise.
- There is no unified system of transparency and accountability of state-owned enterprises.
- Legislation on conflict of interest and corruption (with some exceptions) does not apply to state-owned enterprises.
- The legislation does not set transparent rules for the appointment and dismissal of directors and board members of state-owned enterprises, which is a significant flaw in terms of conflict of interest and corruption, as well as the prevention of political interference in the operation of these enterprises.
- There is no clear methodology or efficient system for the allocation of the profits of state-owned enterprises.
- The National Agency of State Property is unable to effectively coordinate the activities of state-owned enterprises.

The Analysis of the activities of five large state-owned enterprises selected for this report also revealed a number of problems:

- The practice of disclosing information, either proactively or upon request, is unsatisfactory.
- These enterprises do not have any internal mechanisms for preventing conflict of interest and corruption.
- There is an obvious political influence on the management of these enterprises, evidenced by the appointment of persons with close ties to the government to management positions.

- The study revealed a number of cases when family members of public officials were employed in state-owned enterprises.
- The study also found that heads of state-owned enterprises have made donations to the ruling party.

The following recommendations were elaborated based on the above findings:

- Anti-corruption mechanisms must be strengthened through the introduction of standards of transparency, accountability and integrity for state-owned enterprises, and adoption of relevant regulations:
 - The accountability mechanisms and management model for state-owned enterprises must be improved and Parliament must acquire greater oversight powers vis-à-vis these enterprises.
 - The principles of Georgian anti-corruption legislation must be fully extended to cover state-owned enterprises. This includes prevention of corruption and conflict of interest, appointments based on fair and transparent competition, and establishment of clear grounds for dismissals.
 - A code of ethics and mechanisms for whistleblower protection must be elaborated for state-owned enterprises based on international best practices.
 - Principles of disclosure of information, transparency and accountability must be introduced for all state-owned enterprises on the legislative level based on international best practices. State-owned enterprises must be obligated by law to proactively publish information and respond to freedom of information requests.
 - State-owned enterprises must develop remuneration-related, social and environmental policies and publish them on their websites.
- A high standard of transparent, open and fair competition must be set by law for the selection of the heads of state-owned enterprises. Clear and transparent criteria for the selection of the heads and board members of state-owned enterprises must be established by law.
- The practice of political interference in the activities of state-owned enterprises must be eliminated.

2. International Practice and Experience

This study of international best practices related to the management of state-owned enterprises focuses on the following areas: composition of the board of directors, transparency, corruption risks and prevention, proactive disclosure of information.

According to our study of best practices, specific criteria, substantiation and a vision are necessary in order to set up a state-owned enterprise. International experience shows that there may be several criteria for establishing a state-owned enterprise, including market stimulation, provision of goods or services that are in high demand (and which the private sector cannot provide), a weak security environment in a certain area of politics or the economy.

According to research conducted by the State Audit Office, most state-owned enterprises in Ireland operate in the energy, water supply, solid waste processing and transport sectors. In Sweden, they operate in the communications, energy, banking and culture sectors and their total number does not exceed 60.¹

2.1 Transparency of State-owned Enterprises

Transparency of state-owned enterprises is important for the prevention of corruption and other crimes, since these enterprises have to deal with additional challenges, such as: setting standards as high as those of the private companies operating in the market, averting corruption risks that arise from the proximity to political decision-makers, ensuring integrity in the spending of public funds, separating the state's role as an owner from its role as a regulator, preventing political interference in company management.

According to the Organization for Economic Cooperation and Development (OECD), the following information should be disclosed by state-owned enterprises:

- Financial and operating results.
- Commercial objectives and environmental and social policies
- Ownership structure
- Remuneration policy
- Transactions between related parties
- Foreseeable risk factors
- Governance structure and policies ²

The state, as the main owner of the company, in order to ensure its maximum operating efficiency, is required to create an environment, in which Parliament is able to monitor the company's performance, while the media and the public have a clear view of the company's activities.

¹ Audit of the Efficiency of Management and Disposal of State-owned Enterprises, 2015, 23

² *Transparency of State-Owned Enterprises*, Transparency International, 2013, 2-3

For this purpose, the OECD offers specific guidelines for state-owned enterprises:

- It is essential to have a clear separation between the state's role as a market regulator and the owner of a company. It is important to have a clearly defined relationship between the state and a state-owned enterprise in order to avoid conflict of interest and market distortion.³ For this purpose, the Finnish state adopted the *State Shareholdings and Ownership Steering Act* in 2007, which aims to establish regulatory bodies separate from the state as the owner.⁴
- It is important for state-owned enterprises to be transparent and to allow the public to obtain specific information about their goals. For this purpose, the Korean government launched a website where state-owned enterprises disclose both financial and non-financial data following 27 standardized categories.⁵
- State-owned enterprises should disclose the public policy objectives and general service obligations they are pursuing, as well as the costs involved.
- State-owned enterprises should publish annual reports, which are, on the one hand, instruments of accountability to the public and the media, and, on the other hand, allow the companies to monitor their own objectives and activities. This recommendation has been fully implemented by Sweden.⁶

Proactive Disclosure of Information on State-owned Enterprises

Transparency of activities of state-owned enterprises is a major component of the best practices in this area. Proactive disclosure often includes information on organizational structure, salaries and job descriptions, budgets, expenditures and contracts. In this process, attention should also be paid to the exceptions that may be included in the legislation.

There is no consensus on the information that should be proactively disclosed, however, recent discussions and experience with access to information laws reveal the following categories that are generally recommended for disclosure:

- Institutional information and internal regulations.
- Organizational information: information on personnel, name and contact details of public officials.
- Operational information: strategy plans, activities, reports and evaluations.
- Decisions and acts: documents and data used to make decisions, particularly if they affect the public.
- Public services information.
- Budget information: income and expenditure (including salary information).
- Open meeting information: how citizens can attend open meetings.
- Information on decision-making and public participation procedures.

³ *Transparency of State-Owned Enterprises*, Transparency International, 2013,4

⁴ *Transparency of State-Owned Enterprises*, Transparency International, 2013,6

⁵ *Transparency of State-Owned Enterprises*, Transparency International, 2013,5

⁶ *Transparency of State-Owned Enterprises*, Transparency International, 2013,5

- Subsidies information: beneficiaries of subsidies, the objectives, amounts, and implementation.
- Public procurement information: criteria, tender outcomes, copies of contracts and reports on implementation.
- Information on all registers and databases held by the public authority.
- Information on all publications issued.
- Information on the right to access information, deadlines to receive the information and contact details of the responsible person.⁷

Considering the significant economic and social impact of state-owned enterprises on a country's population, high standards of transparency and proactive disclosure of information is directly links with public trust towards them.

According to international standards of access to information, state-owned enterprises should also be obligate to respond to freedom of information requests and proactively public information. Even though the legislation on access to information varies from country to country, the general trend is to have as much information be proactively published as possible and to grant this obligation to as many institutions as possible. Countries like Brazil, Estonia and Spain already obligate state-owned enterprises to proactively disclose information.

International practice shows that openness is the best way to prevent risks associated with the management of state-owned enterprises.

2.2 Anti-corruption Mechanisms in State-owned Enterprises

In order to prevent and eliminate corruption in state-owned enterprises, the following areas need to be considered:

1. Reasonable management and separation of the state's role as the owner and regulator of enterprises.
2. Transparency of the procedures for the selection and appointment of state-owned enterprise management boards.
3. Introduction of internal control mechanisms.
4. Transparency of financial and non-financial information.⁸
5. Adoption of ethics, code of conduct and anti-corruption mechanisms across the entire organization.

The Croatian government set out the following strategy to enhance integrity and reduce corruption in state-owned enterprises: information officers and ethics commissioners were appointed in all state-owned enterprises. All employees were trained in ethics, anti-corruption, financial management and internal control. As a result, 95 percent of state-owned enterprises appointed a supervisory board to monitor anti-corruption, 92 percent appointed an ethics commissioner and 91

⁷ *Proactive Disclosure of Information and State-Owned Enterprises*, Transparency International, 2014, 2-3

⁸ *Anti-corruption Compliance Mechanisms for State-owned Enterprises*, Transparency International, 2015, 1

*percent appointed information officers. This has strengthened transparency, integrity and accountability.*⁹

In addition to the general risks related to corruption, state-owned enterprises face additional challenges that are due to their organizational structure and other characteristics. This creates greater necessity to develop anti-corruption mechanisms, which should be based on the following:

1.1 State-owned enterprises often become victims of short-term political goals, which harms their effectiveness and credibility. The proximity of these enterprises to the state generates favoritism, which greatly increases the risk of corruption.

1.2 While the government's involvement in the selection of the board of directors is natural, it must not be engaged in the daily management of the enterprise. It is also unacceptable for any minister or political official to be a board member of a state-owned enterprise.

1.3 State-owned enterprises must ensure that their internal audit procedures are regular and transparent in nature. State-owned enterprises must also be subject to external audits, which will be conducted independently from their management and owners.

1.4 State-owned enterprises must publish their financial statements in each country they operate in, as well as maintain a website containing the information about their activities in any international language.

1.5 It is good practice to have an ethics code that applies both to the business practices as well as to the personal conduct of employees within the organization. Such ethics code should:

- Prohibit offering or accepting bribes.
- Clearly state that the company's policy on anticorruption applies to all individuals acting on the company's behalf.
- Mandate all employees and company representatives to be aware of the company's code of conduct and anti-corruption policies.
- Establish the guidelines for conflict of interest situations.
- Ensure anonymity when dealing with code of conduct violations.¹⁰

2.3 Best Practice Related to the Appointment of Supervisory Board / Board of Directors of State-owned Enterprises

According to international best practices, a board of directors is the main governing body of any company, including a state-owned enterprise. The board is responsible for the successful operation of a company. Its composition has therefore a significant impact on the company's financial performance. In other words, a board of directors should be composed of qualified and competent

⁹ *Anti-corruption Compliance Mechanisms for State-owned Enterprises*, Transparency International, 2015, 4

¹⁰ *Anti-corruption Compliance Mechanisms for State-owned Enterprises*, Transparency International, 2015, 3-4

members. According to international best practices, a higher level of professionalism of the board can be achieved by:

- Introducing a structured and transparent process of nominating candidates for board membership.
- Defining the roles of the state, as the owner, board of directors and management, and equipping the board with specific responsibilities, such as strategy adoption, selection and supervision of the chief executive officer (CEO), risk management.
- Strengthening the professionalism of the board of directors by separating the functions and responsibilities of the chairperson of board and the company CEO, developing board committees, etc.
- Elaborating board member remuneration and performance evaluation policies.
- Conducting trainings for board members.¹¹

Improving the rules for selecting board members by adopting a framework policy is an important way of efficiently managing a state-owned enterprise. Such a framework includes several critical elements:

- Creation of balanced boards.
- Adoption of professional criteria for the selection, and removal, of board members.
- Development of a structured nomination process.
- Timely appointment and public disclosure of the results.¹²

Best practice involves reduction of government representation in the board of directors. Boards composed mainly of government representatives lack the objectivity and the skills vital to well-functioning boards. For this reason, growing number of countries is taking steps to restrict the appointment of government representatives by:

- Prohibiting ministers and other political appointees from serving on boards, as is the case in many OECD and non-OECD countries.
- Restricting the number of government representatives on boards while increasing the share of private sector members. In India, for example, state-owned enterprises are permitted to have a maximum of two government representatives on the board, usually civil servants from the relevant ministry.
- Prohibiting government officials who have a regulatory role from serving on boards. In Malaysia, to make government-linked corporations more independent, government officials with a regulatory role have been removed from company boards.

When the appointment of government representatives is allowed, however, good practice suggests that additional safeguards be put in place:

- The appointment should only be made where no conflict of interest will arise.

¹¹ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 159-160

¹² *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 163

- The appointment should be made on the basis of relevant skills.
- The delegation of the role to other officials should be prohibited.
- The appointee should be subject to the same performance evaluation as other directors, including during appointment and dismissal.
- The appointee should be responsible for maintaining the same skills and governance competencies as other directors.
- The appointee should be subject to the same terms of appointment as other directors.
- The appointee should not be made board chair or deputy chair.¹³

In conjunction with restricting the number of government representatives, many countries are taking steps to increase the share of private sector members on state-owned enterprise boards, particularly independent members. Some countries have already made this mandatory.

2.3.1 Adoption of Professional Criteria for Selection and Dismissal of Board Members

As more and more countries move toward including independent members in state-owned enterprise boards of directors, professional criteria for the selection of directors become all the more important. In addition to industry-specific knowledge, these criteria also include financial, legal and corporate governance skills.

Selection Criteria - In addition to minimum requirements for education and experience, industrial, financial, business, legal, and corporate governance skills, as well as private sector backgrounds and experience, are carrying more weight. It is also important to determine those criteria, based on which a member may be dismissed. A board of directors that has been selected based on criteria of professionalism can also play a greater role in strategic planning.

Dismissal Criteria - Board members should be appointed for a fixed term, usually one to three years. In many cases, even though board members have finite terms, they may be rotated or removed for no substantiated reasons, or, conversely, may be subject to unlimited renewals. In both cases, clear criteria should guide the process for removing directors. Dismissal standards should be stricter for state-owned enterprises than for private sector companies to avoid the risk of corruption or political interference.¹⁴

2.3.2 Development of a Structured Nomination Process

Under the decentralized model of state-owned enterprise management, relevant ministries typically lead the nomination process for board members. This approach politicizes the management process and makes the nomination process less transparent. To reduce ministerial influence, a number of countries have adopted reforms that delegate part or all of the nomination process to an advisory body, expert panel, centralized ownership entity, or the state-owned enterprise themselves.

¹³ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 166

¹⁴ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 169-171

Conducting the nomination and appointment processes in a timely and transparent manner is particularly important. The appointment of a selected candidate should be made promptly and the selection process should be public.¹⁵

2.3.3 Responsibilities of the Board of Directors

A strong and independent board of directors can successfully take on the central functions of strategic planning, objective setting and major decision-making in a state-owned enterprise. Following best practices, more governments are choosing to delegate decision-making functions related to management and contracts to the board of directors.

The overall governance structure of a state-owned enterprise includes the state (as owner), the board of directors, and the management. The board of directors has a special function in ensuring successful operation of a state-owned enterprise:

- As owner, the state establishes its overall expectations of state-owned enterprises and sets mandates or broad objectives for them.
- The board of directors sets the strategy for achieving the mandates or objectives, oversees the management, and monitors performance.
- The management is responsible for implementing the strategy and is accountable to the board.
- The board of directors fulfills the central function in this governance structure. It has the ultimate responsibility for the performance of the state-owned enterprise, for which it needs the authority, autonomy, and independence to make decisions. It also acts as the intermediary between the state (as the shareholder) and the management of the company and has a duty to act in the best interests of both.¹⁶

2.3.4 CEO Selection and Management Oversight

According to best practice, appointing and retaining qualified management are key functions of any board of directors. However, in many countries the government retains the power to appoint and remove the CEO. Good practice increasingly calls for empowering the board to appoint and, subject to clear terms, remove the CEO, which reinforces the key function of the board in overseeing management and ensures that the CEO is accountable to the board rather than to the government. This also reduces the scope for government interference in operational decision making. Good practice and company law in many jurisdictions also call for the CEO to choose the top management team. Two-tier board systems are the exception, where top management is chosen by either the supervisory board of the government, the latter being less favorable.¹⁷

Empowering boards and delegating greater powers can take place progressively through the following steps:

¹⁵ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 172

¹⁶ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 179

¹⁷ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 188

- First step - ensure that the board oversees key activities and that the state's role in approving or guiding important activities is clear.
- Gradually - the board should begin to oversee management, budgets, strategy, and major expenditures, and the state's policy in approving or guiding these areas should ensure that sufficient autonomy remains with the board.
- Developing essential functions such as selecting the CEO, managing conflicts of interest, and ensuring the integrity of financial reporting, internal controls and internal audit, and risk management systems is critical for the board of directors.
- Ultimately, the goal should be for the board to have full authority and autonomy as provided in company law.
- The responsibilities of a CEO and head of the board of directors must be clearly separated in order to strengthen the board and its oversight of the management team.¹⁸

For the proper functioning of a board of directors, it is also necessary to have the kind of mechanisms of performance evaluation and prevention of conflict of interest that do not diminish its independence.

Conflicts of interest arise when a board member's personal interests contradict those of the state-owned enterprise. According to international practice, the concept of conflict of interest includes a variety of interests. Potential conflicts can include commercial conflicts (in which a board member, a manager, or one of their relatives has an interest in a contract or transaction with the state-owned enterprise, either directly or through, for example, ownership in another company) and political conflicts (in which a government representative pursues a policy goal contrary to the interests of the state-owned enterprise).¹⁹

3. Georgian Legislation

Current Georgian legislative framework does not define the concept of a state-owned enterprise, although the Law on Entrepreneurs does specify the organizational arrangement of those enterprises, where the state holds more than 50% of shares.²⁰ Current legislation does not contain specific criteria for establishing a state-owned enterprise. The legislation also does not regulate the purpose of establishing such an enterprise. Enterprises that have been established with a majority state share are regulated by the general norms of the Law on Entrepreneurs.

3.1 Audit

The audit authority of the State Audit Office extends to enterprises where the state holds a majority of shares. The State Audit Office audits the financial and economic activities of legal entities of

¹⁸ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 188

¹⁹ *Corporate Governance of State-Owned Enterprises, A Toolkit*, World Bank, 2014, 184

²⁰ The Law on Entrepreneurs: Article 9, Paragraph 8; Article 14, Paragraphs 5 and 10; Article 144, Paragraph 7; Article 55, Paragraph 7, Subparagraph f).

private law, where the state holds more than 50% of shares, unless the securities of this enterprise are being traded on a securities market.²¹ Such enterprises must submit the information on their financial statements to the State Audit Office upon request.²²

In addition, according to the June 30, 2015, Order of the National Agency of State Property,²³ annual accounting audit is mandatory for all state-owned enterprises with annual income of more than GEL 10,000. This audit must be conducted in accordance with international standards.

3.2 Accountability

According to Georgian legislation, state-owned enterprises are legal entities of private law²⁴ and are only considered public institutions if they receive funding from the state or local government budget.²⁵ The obligation to disclose information therefore only applies to state-owned enterprises when they are being funded from the state budget and only in relation to this funding. According to existing legislation, state-owned enterprises are accountable to their partners and the tax authority.

Since a state-owned enterprise is considered a subject of private law and is managed independently by a director, it is up to the enterprise to determine whether its financial information is public information or a commercial secret. Hence, according to the National Agency of State Property, state-owned enterprises decide for themselves what kind of information is of public interest and publish this information on their websites.

According to the Agency, it does provide state-owned enterprises with recommendations about disclosure of information. Specifically, based on the recommendation issued by the Agency, some of the larger state-owned enterprises plan to publish information about their activities (that they consider to be public information) on their websites. The Agency website also contains information about those state-owned enterprises that are managed by it. In turn, the National Agency of State Property, as a public institution, is obligated by law to disclose and proactively disseminate public information.

3.3 Conflict of Interests and Corruption

The Law on Entrepreneurs contains a few provisions on conflict of interest in state-owned enterprises. More specifically, by the decision of the Government of Georgia, a supervisory board may be formed in companies where the State holds more than 50 per cent of the total number of votes. In such case, the State representative on the supervisory board may be a public servant if they

²¹ According to the second paragraph of the same article,

²² Law on State Audit Office, Article 17

²³ Order of the National Agency of State Property on Drafting, Submissions and Review of Financial Statements and Business Plans of Enterprises with more than 50% (75% in case of JSCs) State Ownership, June 30, 2015, Articles 2 and 3.

²⁴ Law on Entrepreneurs

²⁵ General Administrative Code

have no conflicts of interest vis-à-vis the enterprise. The members of the supervisory board who are public servants shall fulfill their duties without remuneration and their work shall not be deemed to constitute a conflict of interest with public service.²⁶ Prevention of corruption is regulated by the Law on Conflict of Interest and Corruption in Public Service,²⁷ according to which, heads of enterprises, which are fully (100%) owned by the state or local government, as well as heads of their subsidiaries, are required to file asset declarations.²⁸

However, most of the other anti-corruption provisions in the Georgian legislation do not apply to state-owned enterprises. These include mechanisms for preventing conflict of interest and corruption, and transparent and fair criteria for hiring and dismissal of employees. State-owned enterprises are also not required to have a code of ethics or procedures for protecting whistleblowers.

Georgian legislation is thus not in line with international best practice; Mechanisms for preventing conflict of interest and corruption are weak and ineffective in addressing challenges and problems.

3.4 Rules of Composition of the Supervisory Board

The appointment and dismissal of state-owned enterprises' managers/representatives, and members of supervisory board and other bodies are regulated by the Law on Entrepreneurs and company statutes.

Current legislation does not contain transparent criteria for appointment and dismissal of state-owned enterprise directors and boards of directors. The mechanisms for preventing conflict of interest and corruption in boards of directors are also weak. The general authority of supervisory boards is not clearly regulated at the legislative level either.

The Law on Entrepreneurs does not set different requirements (a higher standard of transparency and fair, competition-based appointment) for the management of state-owned enterprises. A state-owned enterprise's management and director are appointed by the National Agency of State Property based on the Law on Entrepreneurs (Article 9). In the case of state-owned enterprises operating in the medical field, the board is appointed in agreement with the Ministry of Health and/or via competition.

As for the dismissal of company management, the Law on Entrepreneurs states only that a management member may be dismissed on the basis of a statement submitted by an authorized entity, a resignation letter submitted by the directors themselves or a notice of the director's death.

In other words, the law does not establish clear and transparent criteria for the selection and appointment of directors and boards of directors in state-owned enterprises, which would impose a

²⁶ Law on Entrepreneurs, Article 9

²⁷ Law on Conflict of Interest and Corruption in Public Service, Article 2, Paragraph 2, Subparagraph c)

²⁸ Law on Conflict of Interest and Corruption in Public Service, Article 2, Paragraph 2

higher standard compared to private enterprises. The broad discretion of the government (National Agency of State Property or a managing ministry) in appointing the management of state-owned enterprises does not ensure the prevention of corruption, conflict of interest, political interference and pressure. This ultimately results in inefficient management of state-owned enterprises.

3.5 Profit Distribution Rules in State-Owned Enterprises

A decision on how to distribute the annual profit generated by a state-owned enterprise is made by a special commission under the Ministry of Finance through a Government decree. The commission includes the Ministers of Finance, Energy and Education, Deputy Ministers of Health and Finance, and representatives of the Ministries of Economy and Finance.

The commission determines the procedures for the distribution of profit and subsidies. According to a report prepared by the State Audit Office (SAO), there are shortcomings in the activities of the profit distribution. Specifically, there are no regulations on how often and when the commission must assemble. For example, according to the SAO, the commission has not convened since 2013, which creates the following problems: the state is unable to receive profit from the enterprises it has established, while the reinvestment process has been delayed, which hinders the processes of updating inventory and obtaining licenses in state-owned enterprises.²⁹ In addition, the SAO report states that:

“Due to the lack of a clear policy and methodology of profit distribution, it is difficult to assess the expediency and appropriateness of decisions made on reinvestment and transfer of dividends to the state budget. In addition, with respect to the distribution of profits, the state does not actively exercise its authority of being a partner (a primary requirement of the OECD guidelines) - the commission does not convene on an annual basis, which hinders timely and adequate measures. Moreover, the Agency has not established an effective system for receiving dividends from state-owned enterprises in a timely manner.”³⁰

The profit distribution method used by the Partnership Fund is only partially in line with international standards, since the Agency, as a coordinating entity, is completely excluded from the process. This is also negatively assessed by the SAO report.³¹

3.6 Authority of the National Agency of State Property

It is also important to examine how the National Agency of State Property manages state-owned enterprises and ensures prevention of corruption. LEPL National Agency of State Property, as a partner, examines the activities of state companies it runs.

²⁹ Audit of the Efficiency of Management and Disposal of State-owned Enterprises, 2015, 64

³⁰ Audit of the Efficiency of Management and Disposal of State-owned Enterprises, 2015, 67

³¹ Audit of the Efficiency of Management and Disposal of State-owned Enterprises, 2015

The Agency is a partner (shareholder) in state-owned enterprises and exercises its authority based on the existing legislation.³² According to the Agency, it reviews and approves the annual business plans of active state-owned enterprises it manages, and monitors the implementation of these plans on a quarterly basis. If necessary, the Agency also makes decisions related to property and other issues (approval of business plans, liquidation, merger, initiation of bankruptcy proceedings, increases in capital, sale or privatization of property, privatization of state-owned shares, transfer of property to local governments, etc.).

The relevant orders issued by the Agency are binding for the management of state-owned enterprises. According to the Agency, it has developed a data collection form based on international standards, which improves coordination between the Agency and the state-owned enterprises by allowing the latter to submit annual financial reports and draft business plans. The Agency's decision to create a data collection or reporting system is a step towards transparency and effective management of state enterprises. However, according to the SAO report, the system needs to be refined further and brought in line with international standards. One problem is that not all state-owned enterprises are included in this system. The system does not cover the state-owned enterprises managed by ministries. The SAO has recommended introducing a reporting system that is in line with international standards as soon as possible.

As a result of the changes implemented by the National Agency of State Property in 2012, the number of state-owned enterprises managed by it was reduced from 490 to 139 as of September 2016. Of these, 4 enterprises are undergoing liquidation / bankruptcy and reorganization procedures, and 8 are in the bankruptcy process. In addition, the report on the Audit of the Efficiency of Management and Disposal of State-owned Enterprises revealed 75 enterprises, where the state is a partner. The Agency is currently conducting optimization, which involves liquidating inactive enterprises or declaring them bankrupt.

3.7 State-owned Enterprise Management Models in Georgia

According to the report prepared by the State Audit Office (SAO), the existing legislation on managerial functions contains a number of shortcomings. There are three main models for effectively managing state-owned enterprises:

- **Decentralized model** – state-owned enterprises are divided among relevant ministries depending on their area of activity. This model is increasingly losing popularity. For example, all OECD member states have moved to relatively newer, more efficient models.
- **Dual management model** – management of state-owned enterprises is conducted at two levels. Powers are distributed between central coordinating authorities and relevant public agencies.
- **Centralized model** – management of state-owned enterprises is conducted through a single body, which holds a partner's authority over these enterprises.³³ This model has become a trend in recent years, especially in the developed countries. According to the SAO report, this model is

³² Law on Entrepreneurs, Law on State Property, etc.

³³ Audit of the Efficiency of Management and Disposal of State-owned Enterprises, 2015, 26

particularly effective in developing countries, because it allows for a limited number of high-level managers and professionals be gathered in a single institution. This model is also characterized by a more flexible and robust supervision, ensuring sufficient and timely disclosure of information by state-owned enterprises, which also allows for faster identification and elimination of problems.

The National Agency of State Property has transferred the management rights to 17 of its enterprises to relevant ministries on the basis of agreements between the Agency (“the owner”) and each ministry (“the managing party”), which also defines the rights and the obligations of signatory parties. These agreements grant the managing party the authority of a partner, who does not require the consent of the owner (except in specific circumstances outlined in the agreement) to manage the company, e.g. review and approve the company's annual business plans. The company partner is also authorized to examine the activities of the company for the purpose of increasing the efficiency of its management.³⁴

According to current legislation, without the Agency’s consent, the managing party is not authorized to:

- Make decisions about an enterprise's liquidation or insolvency.
- Dispose of an enterprise’s assets and real estate, pledge or otherwise encumber it.
- Make decisions about changing the capital of an enterprise, and disposing or encumbering of its property.

The ministries that have been granted the rights to manage state-owned enterprises are not required to submit financial statements and business plans to the Agency. The latter may request this information if necessary.

According to the audit report, in many cases, the ministries do not report to the Agency about the profitability of the enterprises which they manage. As a result, the Agency does not hold full information about the state-owned enterprises, which prevents problems from being resolved in a timely and effective manner.

The practice of management of state-owned enterprises in Georgia is flawed and only partially in line with international best practice. Despite the existence of a single coordinating body, the latter is unable to properly exercise its authority as a partner, especially vis-à-vis the state-owned enterprises that have been transferred to Ministries for management. This weakens the Agency’s coordinating role.

The state-owned enterprise management model employed in Georgia creates a number of problems, chief among which is the fact that the model does not include aggregate and consolidated reporting procedures, which are useful for seeing the overall picture and conducting full evaluations of state-owned enterprises. As a result, the coordinating body -- National Agency of State Property -- does not have complete information about state-owned enterprises.

³⁴ Law on Entrepreneurs, Agreement on Transfer of Management Rights

4. Analysis of Selected State-owned Enterprises

According to best practice, in addition to the regulations set by the national legislation, in order to establish greater transparency and accountability, state-owned enterprises must include in their statutes mechanisms for ensuring openness and satisfaction of high public interest towards their activities.

Our review showed that transparency and accountability of state-owned enterprises is not regulated at the legislative level in Georgia. There is no standardized and unified system of information disclosure, openness and accountability for state-owned enterprises, which gives rise to significant risks of corruption. Contrary to best practice, disclosure of public information by state-owned enterprises in Georgia depends solely on their good will. This was made evident from the replies received from state-owned enterprises to our requests to disclose information about their management and anti-corruption mechanisms.

4.1 Georgian Post

Georgian Post Ltd. was set up in 1995 on the basis of the Law on Entrepreneurs. The state owns 100% of the company's shares. It is managed by and, therefore, accountable to LEPL National Agency of State Property, a subordinate entity of the Ministry of Economy. The rules for appointing its management are established by the Law on Entrepreneurs and the Labor Code.

The existing legislation does not include any additional obligations of transparency and accountability for the Georgian Post.

The obligation to disclose public information does not apply to Georgian Post, which did not answer most of our questions and instead directed us to its website.

According to the statute of the Georgian Post, its management principles are determined by the Council of Partners and the general director. The Council of Partners makes the decision to appoint and dismiss the general director. The company is thus run by partners through the Council of Partners, whose composition is defined by the statute. The general director manages the company and acts as its representative with third parties.

The statute of the Georgian Post does not include any provisions safeguarding against political influence over its management. Nor does it contain provisions for preventing corruption and conflict of interest.

As for audit, according to the statute, for the purpose of overseeing the company's financial activities, if necessary, the company can invite an independent auditor, who is to be selected in agreement with the partner (the state).

The company's website does not contain information about its organizational structure or management. The website has a section on tenders and auctions, which is not functional as of November 1, 2016. The website does not contain any information on the company's financial performance. In short, the Georgian Post website does not meet any standards set by international best practice.

4.2 Georgian Railway

JSC Georgian Railway has been wholly owned by the Partnership Fund since 2011. The company did not disclose any information about its management system and anti-corruption mechanisms.

The governing bodies of Georgian Railway are the Council of Shareholders, the Supervisory Board and the Board of Directors. The Council of Shareholders is made up of individuals who own shares in the company and are registered in the relevant registry (shareholders). The Supervisory Board has 10 members, of which 2 are independent and another 2 are also members of the Board of Directors. The Board of Directors is elected and dismissed by the Supervisory Board in agreement with the Council of Shareholders. The Supervisory Board appoints the general director and other directors in agreement with the Council of Shareholders.

The Supervisory Board has an audit committee, which also includes an internal audit service. According to the company statute, the Council of Shareholders selects an auditor and has the power to call for an audit of the company. The statute also states that the results of internal and external audits are to be reviewed by the Board of Directors.

The Georgian Railway statute does not determine any anticorruption mechanisms and does not contain any provisions on preventing corruption and conflict of interest.

The Georgian Railway website contains information about the company's mission, organizational structure and management. Information on tenders, vacancies, auctions and company related news is published online too. The company also publishes financial information on its website. The website does not contain the information on investors, environmental measures and remuneration policy.

4.3 Georgian State Electrosystem

The Georgian State Electrosystem (GSE) is a joint stock company that is wholly owned by the Partnership Fund. However, the company is managed by Ministry of Energy on the basis of a civil-legal agreement.

The GSE is a legal entity of private law and therefore is not obligated to disclose public information. The company conducts its procurement in accordance with the public procurement legislation,

meaning that, like all other state-owned enterprises, information related to procurement conducted by the company is available on the State Procurement Agency website.

The company's management consists of the Council of Shareholders and rehabilitation manager / chairperson of the Board of Managers. The Council of Shareholders selects the auditor. The chairperson appoints / dismisses the company's Board of Managers, and determines the number of its members.

According to the GSE statute, 100% of its shares are held by the state (the Partnership Fund). The Partnership Fund runs the company through the Council of Shareholders and has the authority to appoint and dismiss its managers. The Partnership Fund is the sole shareholder. According to the statute, there is no obligation to conduct internal and external audit, although, if necessary, the council of shareholders may request such an audit.

The GSE statute does not determine any anticorruption mechanisms and does not contain any provisions on preventing corruption and conflict of interest.

The company [website](#) contains information about its mission, activities, organizational structure and ownership. Biographies of the Supervisory and the Management Board members are also available online. The website contains information about the company's tenders, financial and other activities, and reports. The website does not contain information on investors, environmental measures and remuneration policy.

4.4 Electricity System Commercial Operator (ESCO)

The Electricity System Commercial Operator was created on the basis of the Law on Entrepreneurs. It is a joint stock company and is wholly owned by the Partnership Fund. Under the Georgian law, ESCO is accountable to the Georgian National Energy and Water Supply Regulatory Commission, the partners and the State Procurement Agency.

ESCO does not have a supervisory board. Its governing bodies/officials are the Council of Shareholders and the general director (see. www.esco.ge, about us, ESCO status, Article 7 of the statute). The general director is appointed and dismissed by the partner based on the Law on Entrepreneurs and the Labor Code. The independence of the management is guaranteed by the Law on Entrepreneurs and the Law on Corruption and Conflict of Interest in Public Service. The latter only applies to the general director.

The company does not have an internal unit responsible for exposing corruption and conflict of interest. Control mechanisms are in place in order to prevent violations of the law. The company has a document determining internal regulations, but does not have a code of ethics.

In its response to Transparency International Georgia's question about the existence of mechanisms for protecting whistleblowers, ESCO stated that the company was guided by the Georgian legislation in this area. However, since the provisions on whistleblower protection that do exist in the Georgian

legislation do not apply to companies (including state-owned enterprises), it is unclear what mechanisms are employed by ESCO. Moreover, the company does not have an internal unit responsible for whistleblower protection.

ESCO operates in accordance with Georgian legislation, the Law on Entrepreneurs, a statute of a commercial operator, and the regulations approved by the general director. The latter is a document of internal use that determines the functions and the responsibilities of structural units, as well as the principles of transparent corporate management, timely decision-making, and coordination between structural units.

The company website contains the information that is required by law. The Communications Manager provides access to information and is obligated to make sure that ESCO responds to questions received from the media, the civil society organizations or the public.

In line with the requirements set by the Energy Minister's Order on Approval of Electricity (Capacity) Market Regulations, ESCO publishes the following information on its website: the amount of electricity purchased and sold during the reporting period, including prices; the amount and prices of balancing electricity purchased.

According to ESCO, it ensures transparency of its activities by publishing certain types of information on its website (www.esco.ge), including monthly, quarterly and annual business plans, financial and area of activity reports.

According to Article 14 of the ESCO Statute, the information exchanged between the shareholder and the company (documents and other data that are not subject to disclosure by law) that includes commercial, or other values, shall be confidential and shall not be disclosed to third parties.

In terms of accountability and transparency, ESCO is accountable to its partners, the Regulatory Commission and the State Procurement Agency, which receive monthly, quarterly and annual business plan, financial and area of activity reports from the company.

Existing legislation does not require ESCO to conduct internal audits. However, the company does conduct annual external financial audits. According to the company, audit reports prepared by audit companies such as BDO and KPMG are sent to the Partnership Fund, the Ministry of Energy and the Regulatory Commission. In addition, annual audit reports are being published on the company website.

ESCO website contains information about its mission, areas of activity, organizational structure and ownership. It also contains information about tenders, financial activities, reports and news. The website does not contain information on investors, environmental measures and remuneration policy. Also missing are the biographies of the members of the supervisory board and the board of directors. In general, the ESCO website is only partially in line with international best practice. Even though the website does contain information about the company's activities, it should also include information about the shareholders, members of the board of directors, environmental measures and the remuneration policy.

4.5 Georgian Oil and Gas Corporation

The Georgian Oil and Gas Corporation (GOGC) is a joint stock company that is wholly owned by the Partnership Fund. However, the company is managed by Ministry of Energy on the basis of a civil-legal agreement.

GOGC is a legal entity of private law and therefore is not obligated to disclose public information. The company conducts its procurement in accordance with the public procurement legislation, meaning that, like all other state-owned enterprises, information related to procurement conducted by the company is available on the State Procurement Agency website.

The GOGC governing bodies are the Supervisory Board and the Board of Directors.

The Board of Directors is chaired by the general director and includes the commercial, financial and technical directors. Each member of the Board of Directors is appointed by the Supervisory Board, which is also authorized to oversee the activities of the company management according to the Law on Entrepreneurs and the company statute.

The company [website](#) contains information about its mission, activities, organizational structure and ownership. The information about the composition of the Supervisory Board and the Board of Directors is also available online. The website contains information about the company's tenders, financial and other activities, and reports. The website also contains information on investors, environmental measures and remuneration policy. However, it does not contain information about anti-corruption mechanisms, and prevention of corruption and conflict of interest.

The GOGC responded to Transparency International Georgia's request to disclose information that a significant part of the information on company activities, including documentation such as audit reports, is available on the company website (www.gogc.ge).

The company also stated that its statute, normative acts regulating its activities and information about its governing bodies is freely available for all interested persons on the Public Registry website.

4.6 Partnership Fund

JSC Partnership Fund was set up in 2011 as a combination of state-owned enterprises formerly working in the areas of energy, transport and infrastructure.

According to the [statute](#) of the Partnership Fund, it is owned by the state. Its governing bodies are the Supervisory Board and the executive body. Its advisory body is the Investment Council. The Supervisory Board is headed by the Prime Minister and also includes 4 government representatives and 4 invited business representatives. The candidates for representing business are jointly selected

from the banking-finance sphere by the Association of Banks of Georgia and LEPL Georgian Chamber of Commerce and Industry.

The composition of the Supervisory Board is determined by the government and the President.

According to the Partnership Fund website, the Supervisory Board currently includes 4 government representatives (Ministers of Economy, Finance, Energy and Justice) and 3 private sector representatives (TBC Bank, Bank of Georgia and Liberty Bank).

The Investment Board consists of experts and representatives from the private sector. The number of members and the composition of the Investment Board is determined by the Supervisory Board.

The Supervisory Board appoints/dismisses the executive body, which is headed by the Chief Executive Officer (CEO). The CEO is appointed/dismissed by the Supervisory Board and is charged with managing and representing the Partnership Fund.

In terms of accountability, the chairperson of the Supervisory Board presents to the government an annual report of the Fund's activities. The Fund is also required to publish an annual audit report of its financial activities. The Fund is managed and represented by its CEO.

According to the statute, the Fund's investment or other types of activities must be transparent, and conducted using fair procedures on the basis of the business best practice. However, the statute does not include anti-corruption mechanisms or any provisions on internal / external audit.

The statute also does not contain provisions ensuring the independence of the Fund's management, political impartiality, possible reasons for the dismissal of the executive management, etc.

In August 2016, Transparency International Georgia published a [study](#) about the transparency of the Partnership Fund. TI Georgia believes that in order to increase the Fund's transparency:

- The Partnership Fund website must be updated to include detailed and verified information about all of its projects.
- Additional regulations must be introduced for the purpose of ensuring the transparency of projects funded by the Partnership Fund. For example, the law should prohibit the funding of legal entities registered in offshore zones or those whose shares are directly or indirectly held by offshore-registered entities.³⁵

The Partnership Fund website contains information about its mission, strategy, structure, governing bodies and their functions.

The website contains information about the Fund's finances and management, including their biographies. Consolidated financial statements and fund ratings are annually published on the

³⁵ *The Partnership Fund Needs to Be More Transparent*, Transparency International Georgia, 2016, <http://www.transparency.ge/node/6176>

website. The Partnership Fund also publishes research related to its activities. The website does not contain information about the Fund's remuneration policy. Similar to other state-owned enterprises, the Partnership Fund only partially meets the standards of best practice. The remuneration policy of the Partnership Fund is in line with best practice; however, in Georgia, state-owned enterprises are not required to disclose this information.

5. Political Influence on the Management of State-owned Enterprises

Political interference in the activities of state-owned enterprises is one of the main risks of corruption in this area. Considering the fact that there is no legal basis for preventing these risks and that the existing anti-corruption legislation in Georgia does not cover state-owned enterprises,³⁶ the practice of the ruling party appointing its political allies as heads of state-owned enterprises is a common practice. Examples of this include the changes in the management of large state-owned enterprises after the 2012 parliamentary elections, instances of a 'revolving door'³⁷ between political positions and managerial positions in these enterprises, and the fact that high-ranking managers of state-owned enterprises have been donating to political parties, while their family members are being employed in those enterprises.

5.1 Changes in the Management of State-owned Enterprises after the 2012 Elections

5.1.1 Georgian Post

The Georgian Post is owned by the Ministry of Economy and Sustainable Development. In 2010, the government decided to privatize the company, but in 2011 it was removed from the privatization list. In March of the same year, former Minister of Finance Kakha Baindurashvili was appointed as chairman of the Georgian Post Supervisory Board, while Levan Sanadze, former high-ranking official in the Ministry of Internal Affairs and head of its LEPL Service Agency, was appointed as its director.

The change of government following the 2012 parliamentary elections also resulted in changes to the leadership of state-owned enterprises. For example, in October 2012, the director and deputy

³⁶ The Law on Conflict of Interest and Corruption in Public Service applies only to the heads of state-owned enterprises by obligating them to file asset declarations; The Law on Public Service, which, among other things, regulates the procedures of competition-based appointment and dismissal in the public service, does not apply to state-owned enterprises.

³⁷ The term 'revolving door' refers to the movement of individuals between positions in the private and the public sectors. Such movement has become more frequent throughout the world in recent years as governments and business communities have developed closer ties. This phenomenon can be beneficial when it allows business and government to share experience, knowledge and practice. However, it is a problem wherever it leads to conflict of interest and corruption, and so compromises the integrity of public decision making, policy formation or contracting. <http://www.transparency.ge/en/blog/intersection-business-and-politics-problem-revolving-door-georgia>

directors of the Georgian Post were changed. Levan Sanadze was replaced by Levan Chikvaidze, who formerly was the director of League of Voters.³⁸

The appointment of Levan Chikvaidze as director was followed by the dismissal of the Supervisory Board, with inefficiency being stated as the official reason. It is unclear why Chikvaidze specifically was appointed as the director and why the board was reconstituted. In general, the process of selecting the company director and board members by shareholders had been vague even before the 2012 elections. It should be noted that the revenue and profit made by the Georgian Post decreased after Chikvaidze's appointment, while his salary increased in 2014.³⁹

5.1.2 Georgian Railway

The leadership and the supervisory board of Georgian Railway also changed after the 2012 parliamentary elections. On November 27, 2012, the Partnership Fund decided to appoint another co-founder of the League of Voters Koka Guntsadze as chairman of the supervisory board. The company's director general also changed. The position has been held by Mamuka Bakhtadze since 2013.

5.1.3 Georgian Oil and Gas Corporation

In November 2012, the Partnership Fund appointed Davit Tvalabeishvili as the director general of the Georgian Oil and Gas Corporation, replacing Zurab Jgharkava.⁴⁰ Several more changes were made in the company's leadership in the following years, including the appointment of Koka Kokolashvili as the commercial director. It should be noted that Davit Tvalabeishvili and Koka Kokolashvili appear on ruling party Georgian Dream's list of donors.

5.1.4 Partnership Fund

Prior to the 2012 parliamentary elections, the Partnership Fund was [headed](#) by the former Prime Minister Nika Gilauri. One of his [deputies](#) was a former Minister of Finance Dimitri Gvindadze.

³⁸ The League of Voters is an organization that was set up during the pre-election period in 2012 by members of the political opposition. Considering the activities and the publicly stated goals and objectives of the organization, the State Audit Office (SAO) recognized the League of Voters as subject to financial monitoring. According to SAO, "the organization's activities involving the checking of voter lists are accompanied by strong political statements, making the foundation's goals and objectives political and electoral in nature. This is also evidenced by public statements made by politically active leaders of the foundation. These individuals communicate their political goals and objectives to the public, which leads to the foundation's activities being perceived as political. Even further evidence of this is the fact that the organization's founders and members have been politically active for years (former MPs, ministers, presidential candidates) and continue to be directly involved in political and electoral activities, for which they use funds obtained from various sources." - <http://sao.ge/news/79>

³⁹ *New Draft Law on Post Hinders Investment*,

<http://eugeorgia.info/ka/article/268/fostis-shesaxeb-kanonproeqti-investiciebs-aferxeb/>

⁴⁰ *New Leadership in Georgian Railway*, GOGC, Civil Georgia, 28.11.2012,

<http://civil.ge/eng/article.php?id=25488&search=>

After the parliamentary elections, the Partnership Fund was headed by Irakli Kovzanadze from November 2012 until 2015, when he was [replaced](#) by Davit Saganelidze, former leader of the Georgian Dream parliamentary majority. Following the 2016 parliamentary elections, Irakli Kovzanadze became a Member of Parliament through the Georgian Dream [party list](#).

5.2 Other Cases of Political Influence on the Management of State-owned enterprises

5.2.1 Former Director General of the Georgian Gas Transportation Company Gia Benashvili

Gia Benashvili, who was a special manager of KazTransGas Tbilisi before and [director general](#) of the Georgian Gas Transportation Company since the Summer of 2015, also became Member of Parliament following the 2016 parliamentary elections through the Georgian Dream [party list](#).

5.2.2 Employment of Former Georgian Dream Representatives in State-owned enterprises

Of interest is the [decision](#) of the Prime Minister to set up a state-owned enterprise under the Mountain Resort Development Company Ltd. that will be tasked with developing the resort Tetnduldi. The company will be headed by a former Georgian Dream MP Soso Jachviani. Cases such as this, when former members of the parliamentary majority are appointed to leadership positions in state-owned enterprises without clear criteria, increase the doubt that these decisions are aimed at ‘rewarding’ persons with close ties to the government rather than ensuring effective management of the enterprise. These doubts were further reinforced by pre-election statements made in 2016 by government representatives regarding their future in the event that they were not included in the party list. For example, Temur Chkuaseli, Georgian Dream MP in the 2012 Parliament, said during a gathering of the parliamentary faction that former Prime Minister Bidzina Ivanishvili had stated that “MPs who will not be included in the party list will move to the executive government, LEPLs, or, in case of interest, to his private business”.

5.2.3 Employment of Former United National Movement Representatives in State-owned enterprises

Another common practice following the 2012 parliamentary elections was the [appointment](#) of representatives of former ruling party United National Movement (UNM) as supervisory board members in the companies owned by the Tbilisi City Hall. For example, in November 2012, Tbilisi City Hall set up a company named City of Light Ltd. and appointed Koba Khabazi, Lado Vardzelashvili and other UNM members as supervisory board members. [Former UNM MP] Khatura Ochiauri was appointed as supervisory board member in another company owned by Tbilisi City Hall Tbilisi Transport Company Ltd.

5.3 Family Members of Public Officials Employed in State-owned enterprises

Irakli Shotadze – Chief Prosecutor

Irakli Shotadze filed his 2014 and 2015 asset declaration as the First Deputy Chief Prosecutor, and the 2016 declaration as the Chief Prosecutor. According to the 2016 asset declaration, his father Jemal Shotadze is a consultant at the Technical Service of JSC Georgian Railway. Jemal Shotadze received GEL 21,440 in 2015 and GEL 9,520 in 2015 from this position. The 2014 declaration does not mention Jemal Shotadze, which likely means that he was not employed at Georgian Railway in 2014.

Giorgi Badashvili – Head of the Investigative Service of the Ministry of Finance; Former Chief Prosecutor

Giorgi Badashvili filed his first asset declaration in 2013 as deputy director of the Anticorruption Agency at the Ministry of Internal Affairs. In 2014 and 2015, he filed his declarations as the Chief Prosecutor, and in 2016 as Head of the Investigative Service of the Ministry of Finance. According to his 2013 and 2014 asset declarations, his father Nugzar Badashvili was a lawyer at Solid Waste Management Company Ltd., where his annual income was GEL 8,223 in 2012 and GEL 20,580 in 2013. According to the 2015 and 2016 declarations, Nugzar Badashvili was employed at the Control and Audit Department of JSC Georgian Railway and had received annual income of GEL 39,196 in 2014 and GEL 56,202 in 2015.

Ioseb Gogashvili – First Deputy Head of the State Security Service

Ioseb Gogashvili filed his first asset declaration in 2013 as Deputy Head of the Operational Support Department at the General Inspectorate of the Ministry of Internal Affairs. He was appointed as Head of the General Inspectorate in 2014, as First Deputy Minister of Internal Affairs in 2015, and as First Deputy Head of the State Security Service in 2016. Gogashvili had not included information about the employment of his family members in his 2013 declaration. According to his 2014 declaration, his wife Tea Martkopelashvili was the chief specialist at JSC Georgian Oil and Gas Corporation and received annual income of GEL 12,000 in 2013. According to the 2015 declaration, his wife received an income of GEL 31,318 from the same position in 2014. According to the 2016 declaration, his wife had become Deputy Head of Administration at Georgian Gas Transportation Company Ltd., where she received an annual income of GEL 59,280.

Natia Mikeladze – Former Deputy Minister of Economy and Sustainable Development

Natia Mikeladze served as Deputy Minister of Economy and Sustainable Development from 2012 to 2015. According to her 2012 and 2013 asset declarations, her husband Giorgi Chkhikvadze was head of the Gori Central Warehouse of United Water Supply Company of Georgia. The 2014 declaration does not include information about Chkhikvadze's income. According to the 2015 declaration, Giorgi Chkhikvadze had become a specialist at Marabda Kartsakhi Railway and had received annual income of GEL 26,183.

Irakli Khmaladze – Deputy Minister of Energy

Irakli Khmaladze has served as Deputy Minister of Energy since 2014. For several years before that, he was Head of the Legal Department at the Ministry of Energy. According to his 2008-2014 asset declarations, his wife Tamar Mtskhvetadze was an employee of LEPL Public Registry. According to the 2016 declaration, Mtskhvetadze had also received an income of GEL 16,500 as chief specialist at JSC Georgian State Electrosystem.

Zurab Pataradze – Chairman of the Government of the Autonomous Republic of Adjara; Former Ambassador to Kazakhstan

In 2014-2016, Zurab Pataradze filed his asset declarations as the ambassador to Kazakhstan. Currently, he is chairman of the Government of the Autonomous Republic of Adjara. The 2014 declaration does not contain information about the employment of his wife Sopio Bakuridze. According to the 2015 and 2016 declarations, Bakuridze was the Marketing and PR Specialist at the Kazakhstan branch of JSC Georgian Railway, for which she received an annual income of USD 8,000 in 2014 and USD 9,600 in 2015.

Vladimer Khundadze – Head of the Customs Department of the Ministry of Finance LEPL Revenue Service

In 2013-2014, Vladimer Khundadze served as acting Head of the Customs Department of the Ministry of Finance LEPL Revenue Service. In 2015 and 2016, he filed his asset declarations as Head of this the Customs Department. According to the 2013 declaration, his wife Khatuna Pkhaladze worked for several companies, with Georgian Post Ltd. not being one of them. According to the 2014, 2015 and 2016 declarations, Pkhaladze had worked as Head of Terminal Service at the Transportation Department of Georgian Post Ltd. since 2013, and received annual income of GEL 19,399 in 2013, GEL 26,315 in 2014, and GEL 26,599 in 2015.

Otar Lashaghashvili – Head of Legal Department of the Ministry of Economy and Sustainable Development

In 2012, 2013 and 2014, Otar Lashaghashvili filed his asset declarations as acting Head of Legal Department of the Ministry of Economy and Sustainable Development. During this period, he had not declared any income received by his family members from performing paid work. According to his 2016 declaration, his sister Tamta Lashaghashvili was appointed as a PR specialist at Mountain Resorts Development Company Ltd. and received annual income of GEL 14,400. The company Mountain Resorts Development Company Ltd. is wholly owned by the state and is managed by the National Agency of State Property, which itself is a state body subordinated to the Ministry of Economy.

Vano Naskidashvili – First Deputy Governor of Akhmeta Municipality

Vano Naskidashvili filed his 2008-2010 asset declarations as First Deputy Governor of Akhmeta Municipality, his 2012-2013 declarations as Deputy Governor and his 2014-2015 declarations again as First Deputy Governor. According to the 2008 declaration, his wife Khatuna Turmanauli was

employed at the Akhmeta branch of the People's Post. Since 2009, she has worked as Chief Accountant at Akhmeta Municipality Public Service Ltd.

5.4 Heads of State-owned Ltds and JSCs as Donors to the Ruling Party

[According](#) to the National Agency of State Property, it currently manages 329 state-owned enterprises. Apart from these, the Partnership Fund [holds](#) a 100% of the assets of Georgian Railway, Georgian Oil and Gas Corporation, Georgian State Electrosystem, Electricity System Commercial Operator and 24.5% of Telasi. The topic of remuneration received by the leadership and employees of state-owned enterprises has drawn public attention on several occasions. On February 12, 2014, during his [meeting](#) with the Economy Council, Prime Minister Irakli Gharibashvili ordered the council members to study the issue; however, no further steps have been taken in this direction. Transparency International Georgia examined the lists of political party donors and identified the links the heads of state-owned enterprises have with the former and current ruling parties.

- On August 26, 2016, director general of Georgian Lottery Company Ltd. and Georgian Post Ltd. Levan Chikvaidze donated GEL 27,900 to Georgian Dream – Democratic Georgia. On May 10, 2013, he also donated GEL 20,000 to Georgian Dream – Democratic Georgia. It should be noted that Chikvaidze has not included this donation in his [asset declaration](#).
- On August 19, 2013, executive director of JSC Partnership Fund (then parliamentary majority leader) Davit Saganelidze donated GEL 15,000 to Georgian Dream - Democratic Georgia.
- On April 26, 2013, director general of JSC Georgian Oil and Gas Corporation Davit Tvalabeishvili donated GEL 35,000 to Georgian Dream – Democratic Georgia.
- On April 26, 2013, commercial director of JSC Georgian Oil and Gas Corporation Koka Kokolashvili donated GEL 30,000 to Georgian Dream – Democratic Georgia.
- On August 22, 2013, deputy chairman of the supervisory board of Marabda-Kartsakhi Railway Ltd. Gia Saganelidze donated GEL 15,000 to Georgian Dream – Democratic Georgia.
- On July 19, 2013, supervisory board member of JSC Georgian Railway Guram Gabunia donated GEL 5,000 to Georgian Dream – Democratic Georgia.
- On August 1, 2012, deputy executive director of the JSC Partnership Fund Natela Turnava donated GEL 35,000 to the United National Movement.
- On August 2, 2012, director general of JSC Georgian Railway Mamuka Bakhtadze donated GEL 20,000 to the United National Movement.
- On September 5, 2012, director general of Tbilisi Transport Company Ltd. Aleksandre Japaridze donated GEL 10,000 to the United National Movement.

6. Conclusions and Recommendations

This study's key findings can be summarized as follows:

- Anti-corruption mechanisms, as well as transparency, accountability and integrity standards in state-owned enterprises are weak. This is, among other things, caused by the lack of relevant regulations at the legislative level. For example:
 - Contrary to the international best practice, there is no interaction in Georgia between the Parliament and state-owned enterprises. More specifically, there is no procedure of accountability of state-owned enterprises to Parliament, which would serve as an additional mechanism of overseeing state-owned enterprises and their supervisory state bodies.
- The National Agency of State Property is unable to oversee the activities of state-owned enterprises whose management has been delegated to ministries. This weakens the Agency's role of serving as a coordinating body and creates a number of problems in the management of state-owned enterprises.
- Georgia's anti-corruption legislation (the Law on Conflict of Interest and Corruption in Public Service and the Law on Civil Service), which defines the mechanisms for preventing conflict of interest and corruption, as well as transparent and fair criteria for appointment and dismissal of public servants, does not fully apply to state-owned enterprises. The Law on Conflict of Interest and Corruption in Public Service applies only to the heads of state-owned enterprises by requiring them to file asset declarations. The Law on Civil Service, which, among other things, regulates the procedures of competition-based appointment and dismissal in the civil service, does not apply to state-owned enterprises.
 - Contrary to the international best practice, Georgian legislation does not contain a requirement for state-owned enterprises to have a code of ethics or mechanisms for whistleblower protection.
 - State-owned enterprises examined in this study have not published remuneration policies or social and environmental policies on their websites.
- Transparency and accountability of state-owned enterprises is not properly regulated at the legislative level.
 - There is no standardized and unified system of information disclosure, openness and accountability for state-owned enterprises, which gives rise to significant risks of corruption. Contrary to the best practice, disclosure of public information by state-owned enterprises in Georgia depends solely on their good will. This was made evident during the course of our research. State-owned enterprises decide for themselves what information about their activities is of public interest and post this information on their websites.
- The Law on Entrepreneurs does not establish additional requirements (higher standards of transparent and fair competition-based appointment) for the management of state-owned enterprises. The law does not include clear and transparent criteria for the selection and dismissal of directors and board members of state-owned enterprises, which would impose a higher standard for state-owned enterprises.

- The broad discretion of the government in appointing the management of state-owned enterprises does not ensure prevention of corruption, conflict of interest, and political interference and pressure. This ultimately results in an inefficient management of state-owned enterprises.
- Political interference in the activities of state-owned enterprises is one of the main risks of corruption in this area. This risk is made evident by the changes in management of large state-owned enterprises following the 2012 parliamentary elections, instances of a ‘revolving door’⁴¹ between political positions and managerial positions in these enterprises, the fact that heads of state-owned enterprises have been donating to political parties, and that their family members are being employed in these enterprises.
- The practice of employing members of the ruling political party in state-owned enterprises has been common during both the previous and the current government.
- Considering the fact that there are no clear employment criteria for state-owned enterprises, cases of employment of family members of public officials in state-owned enterprises creates a perception that employment in state-owned enterprises is based on political affiliation or nepotism.
- Heads of some large state-owned enterprises have donated money to the ruling party and acted as sponsors of its election campaigns. The directors and board members of state-owned enterprises have funded and continue to fund the ruling party.

The following recommendations were elaborated based on the above findings:

- Anti-corruption mechanisms must be strengthened through the introduction of standards of transparency, accountability and integrity for state-owned enterprises, and adoption of relevant regulations:
 - Accountability mechanisms and the management model of state-owned enterprises must be improved and Parliament must be granted greater oversight powers vis-à-vis the state-owned enterprises.
 - The principles of Georgian anti-corruption legislation must fully apply to state-owned enterprises. This includes prevention of corruption and conflict of interest, appointment based on fair and transparent competition, and setting of clear reasons for dismissal.
 - A code of ethics and mechanisms for whistleblower protection must be elaborated for state-owned enterprises based on best practice.
 - Principles of disclosure of information, transparency and accountability must be introduced for all state-owned enterprises on the legislative level based on the best practice. State-owned enterprises must be obligated by law to proactively publish information and respond to freedom of information requests.

⁴¹ The term ‘revolving door’ refers to the movement of individuals between positions in the private and the public sectors. Such movement has become more frequent throughout the world in recent years as governments and business communities have developed closer ties. This phenomenon can be beneficial when it allows business and government to share experience, knowledge and practice. However, it is a problem wherever it leads to conflict of interest and corruption, and so compromises the integrity of public decision making, policy formation or contracting. <http://www.transparency.ge/en/blog/intersection-business-and-politics-problem-revolving-door-georgia>

- State-owned enterprises must develop remuneration, social and environmental policies and publish them on their websites.
- A high standard of transparent, open and fair competition must be set by law for the selection of heads of state-owned enterprises. Clear and transparent criteria for the selection of heads and board members of state-owned enterprises must be determined by law.
- The practice of political interference in the activities of state-owned enterprises must be eliminated. While the government's involvement in the nomination of board members is in line with the best practice, it must not be involved in the daily management of a state-owned enterprise. It is also unacceptable for any Minister or political official to be a board member of a state-owned enterprise.